PHILANTHROPY AND ENTERPRISE: HARNESSING THE POWER OF BUSINESS AND ENTREPRENEURSHIP FOR SOCIAL CHANGE

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EXECUTIVE SUMMARY:

Social entrepreneurs and supportive philanthropists are challenging conventional assumptions by deliberately using business ventures to serve the public good. This idea of using market forces in strategic ways to promote social improvements is not new, but what is new is the openness and enthusiasm with which entrepreneurial, market-oriented approaches are being embraced as an integral element in creating lasting social change. This is particularly true when the social problem being addressed is poverty in the developing world. In most developing countries, there are serious barriers to market development which prevent the poor from participating in useful economic relationships. Philanthropists can add value by directing their capital and resources to the ventures most likely to remove these barriers and engage the poor in constructive ways. In order for such business ventures to achieve lasting social impact, those who support them must address new challenges that arise and gain a better understanding of the conditions under which they operate and how philanthropists and social investors can best contribute.

> I have never known much good done by those who affected to trade for the public good. It is an affection, indeed, not very common among merchants,

and very few words need be employed in dissuading them from it. --Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*[1]

As we enter the 21st century, over two hundred years since Adam Smith penned those words, his wisdom on this matter is being challenged by social entrepreneurs and supportive philanthropists who are deliberately using business ventures to serve the public good. George Soros candidly describes his own change of heart on this matter: "Where I have modified my stance is with regard to social entrepreneurship. I used to be negative toward it because of my innate aversion to mixing business with philanthropy. Experience has taught me that I was wrong. As a philanthropist, I saw a number of successful social enterprises, and I became engaged in some of them."[2]

The idea of using market forces in strategic ways to promote social improvements is not new. Many donors have made grants and program-related investments to enterprises that serve their philanthropic missions, including investments in some organizations that take the legal form of a for-profit venture. Without this philanthropic support, microfinance, for instance, would not have grown nearly as quickly and would not be reaching the 100 million or so that it is serving today.

What is new is the openness and enthusiasm with which entrepreneurial, market-oriented approaches are being embraced as an integral element in creating lasting social change. Established philanthropists are opening to this idea, and new philanthropic organizations are being designed to embrace it. The Acumen Fund was established in 2001 explicitly to use "entrepreneurial approaches to solving the problems of global poverty." With founding support from Cisco Systems Foundation, Rockefeller Foundation, Kellogg Foundation, and many others, Acumen was designed to invest in "enterprises" that deliver "affordable, critical goods and services – like health, water and housing – through innovative market-oriented approaches." In 2004, Pierre Omidyar, founder of E-Bay, and his wife Pam decided to restructure their philanthropic activities, dramatically replacing the Omidyar Foundation with the Omidyar Network, a limited liability company that could make investments in for-profits, as well as nonprofits.[3] In 2006, when the founders of Google, a wildly successful Internet search and media company, took steps to formalize their company's "philanthropic" arm, they announced that it would be structured as a for-profit organization, "allowing it to fund start-up companies, form partnerships with venture capitalists and even lobby Congress."[4] These are just a few of the most visible examples.

This trend is a reflection of a wider social entrepreneurship movement that emerged in the final decades of the twentieth century and has been accelerating into the twenty-first.[5]

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[1] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Edwin Cannan (ed.), (Chicago: University of Chicago Press, 1976): 478 (originally published in 1776).

[2] George Soros, *Open Society: Reforming Global Capitalism*, (New York: Public Affairs, 2000): 162.

[3] Private foundations can and do invest in for-profits that serve their missions, but there are restrictions on this kind of activity to prevent self-dealing. A for-profit "philanthropy" avoids that issue.

[4] Katie Hafner, "Philanthropy Goggle's Way: Not the Usual," New York Times, September 14, 2006.

[5] See J. Gregory Dees and Beth Battle Anderson, "Framing a Theory of Social Entrepreneurship: Building on Two Schools of Practice and Thought," *Research on Social Entrepreneurship: Understanding and Contributing to an Emerging Field*, ARNOVA Occasional Paper Series, vol. 1 no. 3, 2006, Rachel Mosher-Williams (ed.); and J.

This movement challenges old sector boundaries and encourages innovative approaches, using the tools from any sector that are most likely to be effective.[6] The logic for including entrepreneurial business ventures as part of the tool kit can be boiled down to three principles:

1. *Business ventures and markets can play an important role in creating lasting improvements in social conditions.*
2. *Entrepreneurs are particularly well positioned to discover and craft innovative approaches for addressing social problems.*
3. *Philanthropists have an essential role to play in stimulating, supporting, shaping, and even subsidizing socially beneficial entrepreneurial business activities.*

In this paper, I will state the arguments for each of these principles, particularly in the context of poverty reduction, the focus of this conference.[7] I will then explore the new challenges facing philanthropists who use enterprise as a tool for achieving their social objectives, and will close with observations about how we should move forward.

BUSINESS, MARKETS, AND LASTING SOCIAL CHANGE

Proponents of the philanthropic use of enterprise point out that social and economic issues are inextricably intertwined. Anyone who wants to create lasting solutions to social problems would be wise to include business methods and market-oriented approaches as *part* of their overall tool kit. This is particularly true when the social problem being addressed is poverty in the developing world. They are not claiming that all social problems are amenable to market-based solutions or that any major social problem will be solved by business methods alone.

This reflects a turn away from charity, in the classic alms-giving sense. While charity may be necessary to relieve the symptoms of severe poverty, most of those fighting poverty would agree charity does not provide a lasting solution. Some, such as Muhammad Yunus, the founder of Grameen Bank, pioneer in microfinance, and 2006 Nobel Laureate, believe charity can be downright harmful. He observes, "When we want to help the poor, we usually offer them charity. Most often we use charity to avoid recognizing the problem and finding a solution for it... Charity is no solution to poverty. Charity only perpetuates poverty by taking the initiative away from the poor. Charity allows us to go ahead with our own lives without worrying about those of the poor. It appeases our consciences."[8] Not all proponents of social entrepreneurship would be as harsh in their assessment of charity, but most of them take pains to distinguish their work from charity.

Gregory Dees, "Taking Social Entrepreneurship Seriously: Uncertainty, Innovation, and Social Problem Solving," *SOCIETY*, vol. 44, no. 3, March/April 2007.

[6] It is important to note that social entrepreneurship is not simply about enterprise creation. It is about finding innovative solutions to social problems. Enterprise is only one tool social entrepreneurs might use. For a general introduction to the concept, see David Bornstein, *How to Change the World: Social Entrepreneurs and the Power of New Ideas*, (Oxford University Press: New York, 2004).

[7] Social enterprise is not simply about poverty reduction. Enter[rise can be used to address any area of potential social improvement, including health care, education, the environment, the arts, and so on.

[8] Muhammad Yunus, *Banker to the Poor: Micro-lending and the battle against world poverty*, (New York: Public Affairs, 1999): 237.

Many things can improve the quality of life and the life chances of the poor, such as education, health care, clean water, and reduced conflict, but none of these will do much to alleviate poverty without opportunities for economic participation and empowerment.[9] Martin Fisher, a social entrepreneur whose organization, KickStart, sells irrigation pumps in Kenya and Tanzania, frames the argument:

> Within less than a generation, poor families in Africa have been thrown from essentially a subsistence lifestyle into a primarily cash-based economy. Ability to earn income is suddenly a paramount skill. Yet approaches to development continue to be based on the assumption that the primary need of people in poor places is something other than a way to make money—better healthcare, education, water, housing, and so forth. This is misguided. . . . The way to address the challenge of persistent poverty is to create sustainable income-earning opportunities for millions of people. Income is development.[10]

Income is central, but Fisher's logic should be extended to other forms of economic participation as well. Increases in income alone are not enough to improve the quality of life for the world's poor. As people increase their earnings, they need access to markets with suitable and affordable products and services on which to spend their income and through which to improve the quality of their lives.[11] They also need access to savings institutions in order to build financial reserves as a cushion against tough times and as a source of capital to invest in education, housing, or business opportunities. Finally, the poor need access to credit that will allow them to leverage their own resources to improve their quality of life and productive capacity. Anyone who is serious about finding lasting solutions to poverty needs to consider supporting economic participation in these four key roles:

Producer: Income generating and productivity enhancing opportunities
Consumer: Affordable, important quality-of-life goods
Saver: Secure and accessible methods to accumulate financial assets
Borrower: Capital on reasonable terms

In most developing countries, there are serious barriers to participation in each of these roles by the poor. Markets developing on their own typically have been slow in providing avenues of participation for the poor. Social enterprises commonly address one or more of these dimensions of economic participation.

ENTREPRENEURSHIP, INNOVATION, AND DISCOVERY

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[9] See Nicholas Stern, Jean-Jacques Dethier, and F. Halsey Rogers, *Growth and Empowerment: Making Development Happen*, (Cambridge, MA: The MIT Press, 2005): esp. 225-242.
[10] Martin Fisher, "Income Is Development: KickStart's Pumps Help Kenyan Farmers Transition to a Cash Economy," *Innovations*, (vol. 1, no. 1, Winter 2006): 9.
[11] This is where efforts to create products for the "base of the pyramid," the world's poorest, can play an important role. See C. K. Prahalad's *The Fortune at the bottom of the Pyramid: Eradicating Poverty through Profits*. (Upper Saddle River, NJ: Wharton School Publishing, 2005) and Stuart Hart's*Capitalism at the Crossroads: The Unlimited Business Opportunities in Solving the World's Problems*, (Upper Saddle River, NJ: Wharton School Publishing , 2005).

In theory, existing large corporations could take on the job of supporting economic engagement by the poor. Why support relatively new, small, entrepreneurial efforts? We have strong evidence that economies work best when they empower independent entrepreneurs to engage in innovation alongside larger organizations. Entrepreneurs engage in a process of innovation, experimentation, and adaptation that is much more difficult to execute in more centralized, bureaucratized, or politicized environments. Entrepreneurs are not constrained by the rules, budgets, cultures, or politics of larger organizations. According to William Baumol and his colleagues, "Radical breakthroughs tend to be disproportionately developed and brought to market by a *single individual or new firm*."[12]

Proponents of social entrepreneurship hold that the social sector needs the same kind of independent innovators to develop effective, high-potential solutions to social problems. To quote Soros again, "Philanthropy, social work, and all forms of official intervention are mired in bureaucracy. Yet there are imaginative, creative people who really care about social conditions. I have come around to thinking that entrepreneurial creativity could achieve what bureaucratic processes cannot."[13] If there is an arena in which we need breakthrough innovations, it is in poverty reduction.

Entrepreneurs have flexibility to take risks, learn, and adapt as they go. Many will fail, and many others will significantly modify their original ideas as they learn what works and what does not. They serve as an important learning laboratory for society. This is important because there is no way to know in advance what will work as a tool for solving a persistent social problem, such as poverty. Entrepreneurs act as "Searchers," to use William Easterly's term. "A Searcher admits he doesn't know the answers in advance; he believes that poverty is a complicated tangle of political, social, historical, institutional, and technological factors. A Searcher hopes to find answers to individual problems only by trial and error experimentation."[14] This is much harder to do from within a bureaucratic environment, which tends to favor those Easterly calls "Planners."

Major corporations may have a role to play in addressing social issues, including poverty, but they are not a substitute for social entrepreneurs. In fact, social entrepreneurs often serve as the catalysts for engaging larger firms. They do this by finding opportunities that would escape the notice of larger firms, demonstrating the profitability of a new product-market, and/or providing a valuable complementary service, perhaps as part of what Bill Drayton, founder of Ashoka and pioneer in social entrepreneurship, calls a "hybrid value chain."[15] Major banks are getting involved in microcredit only now that the market is established, and they are typically engaging only at a secondary market level, leaving the loan origination and collection process to a local social enterprise. It is not clear how much large

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[12] William J. Baumol, Robert E. Litan, Carl J. Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity*, (New Haven: Yale University Press , 2007): 86, italic emphasis in the original.
[13] George Soros, *Open Society: Reforming Global Capitalism*, (New York: Public Affairs, 2000): 162.
[14] William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, (New York: The Penguin Press , 2006): 6.
[15] See http://ashoka.org/hvc for a brief explanation. The concept is also discussed in Jane Nelson and Beth Jenkins, "Investing in Social Innovation: Harnessing the Potential of Partnership Between Corporations and Social Entrepreneurs," Corporate Social Responsibility Initiative Working Paper No. 20, March 2006, Cambridge, MA: John F. Kennedy School of Government, Harvard University.

corporations would do, particularly by publicly held companies, in the absence of social entrepreneurs.

SELECTED ENTERPRISING SOCIAL INNOVATIONS:

A number of social entrepreneurs are combining their creativity with the use of business methods to increase the economic participation of the poor.

Poor as Producers: KickStart provides technologies that help generate income for the poor. Its main product is a relatively low-cost portable human-powered irrigation pump that it markets to farmers in Kenya and Tanzania. This technology significantly increases crop yields and income for poor farmers. In a recent article, co-founder, Martin Fisher states that over 59,000 pumps have been sold, leading to the creation of over 40,000 new businesses, 22,000 new wage jobs, and $40 million in new profits and wages.[1] KickStart continues to innovate by developing new productivity tools, including smaller, lower cost pumps to increase the market.[1]

Poor as Consumers: Scojo Foundation serves poor consumers by making reading glasses available and affordable. It does this through low cost production, a distinctive micro-franchise distribution system, and partnerships with some major NGOs. The Scojo Foundation achieves low cost of production (about $1 per pair of glasses delivered in country) in part by leveraging its partnership with the for-profit Scojo Vision, LLC. By distributing through a creative franchise system, Scojo not only reaches remote areas at low cost, but helps provide a source of income for the vision entrepreneurs who hold the franchises, as well. Scojo has sold over 50,000 pairs of glasses in Guatemala, El Salvador, and India, and has the goal of selling 1 million pairs by 2110.[1]

Poor as Savers: Opportunity International, a pioneer in micro-finance, operates through a network of 42 organizations in 28 developing countries. In 2000, it began operating formal financial institutions that are able to provide a wide range of financial services, including savings accounts. Administering savings accounts can be difficult in countries with high degrees of illiteracy and low levels of official identity documentation. To address this problem, Opportunity has begun using biometric fingerprint readers and "smart cards" to replace signatures. This paperless process has made banking more widely available to the poor. According to information provided by the organization, Opportunity banks opened nearly 250,000 accounts in 2006, worth nearly $160 million.[1]

Poor as Borrowers: The pioneers of microcredit are relatively well known. However, the process of innovation continues today with new entrants. Consider Kiva, an organization that uses the Internet to connect entrepreneurs in developing countries with individuals who have money to lend.[1] Kiva works with local microfinance partners to screen the entrepreneurs and up load information about them, their businesses, and their financial needs. Individual lenders choose to lend a portion or all of the amount requested, as little as $25. The local microfinance partner tracks the performance of the business and collects the repayments. Performance of the partners is tracked online. When the loan is repaid, the Kiva lender has a choice to re-lend the money or withdraw it. In just over two years, Kiva has reportedly brokered over $6 million in loans to some 9,000 entrepreneurs from some 50,000 lenders.

PHILANTHROPIC VALUE ADDED

Philanthropists can add value by accelerating market development in ways that improve the lot of the poor, directing their capital and resources to the ventures most likely to engage the poor in a constructive way. It is only natural for the profit-seekers (both entrepreneurs and capital providers) who are driving market expansion in developing countries to start with what they see to be the low hanging fruit, highest return relative to the capital provided. Businesses that engage the poor in constructive ways are typically seen as costly and risky. Profitability, if it comes at all, may be a long way out. By contrast, philanthropists are in a position to make these investments because profits are not their primary consideration. They can take risks, subsidize higher cost structures, and be more patient than profit-seeking investors. It is useful to think of this kind of philanthropic support falling in three categories, though the boundaries can be blurry.

Supporting social enterprises to achieve social impact.[16] Social enterprises have a social purpose, and they often need patient, low-return or no-return capital to pursue that purpose. As Soros notes, "in social entrepreneurship, profit is not a motive, it is a means to an end."[17] Social entrepreneurs are valuable because they have an inherent incentive to find opportunities where others are not even looking and to develop innovative approaches that make the opportunities into viable enterprises, when possible. If Yunus were simply looking for the best profit opportunities in Bangladesh, he would not have focused on microcredit and would not have crafted Grameen's innovative peer-lending model. Because he was determined to reduce poverty in his country, he saw an opportunity and engaged in a process of innovation that would otherwise have been neglected. Philanthropic capital was crucial for start-up and the rapid early expansion. This is true for most ventures started by social entrepreneurs, including those mentioned in this paper. Philanthropists are a good fit because they are focused more on social return than financial return. The Ford Foundation's support for Grameen is a good example. Even with on-going subsidies, a social enterprise might represent the most cost effective use of philanthropic funds.

Helping social enterprises move into mainstream capital markets. Some social enterprises may always need a philanthropic subsidy; others may become "self sustaining" or channel their modest profits back into their social mission. However, many have the goal of becoming commercially viable, able to provide market-rate returns to investors and, thus to tap into mainstream capital markets. Some social entrepreneurs see this as the only way to achieve sufficient scale, given the limits on philanthropic capital. Philanthropists can make enterprise investments explicitly to demonstrate the commercial viability of businesses that serve the poor. This is the logic behind the Omidyar-Tufts Microfinance Fund. The Fund was created with a $100 million endowment gift from Pierre and Pam Omidyar to Tufts University to invest in microfinance, "demonstrating its potential commercial viability to a wider institutional investor audience." [18] These kinds of philanthropic investments are not about providing subsidies, accepting low returns, or demonstrating great patience. They are about generating market-rate returns in a timely fashion so as to attract mainstream capital.

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[16] Note that not all examples of social entrepreneurship take the form of business enterprises. Also note that the enterprises that philanthropists support are not all social enterprises.
[17] George Soros, *Open Society: Reforming Global Capitalism*, (New York: Public Affairs, 2000): 162.
[18] See press release at http://www.tufts.edu/microfinancefund/?pid=8.

Supporting socially beneficial forms of private enterprise. A business enterprise does not have to be a social enterprise to improve social conditions. As Adam Smith pointed out, businesses frequently serve the public good without having the specific intention to do so. Philanthropists may wish to support selected private enterprises when these happen to serve the poor or provide other social improvements. By making these investments, philanthropists can help accelerate market development and influence the direction of that development in ways that increase constructive participation by the poor. In countries without an infrastructure to support entrepreneurship, markets are likely to favor those who have power, connections, and resources. As a result, many talented profit-seeking entrepreneurs will lack access to the kind of capital and expertise they need to launch and grow their businesses. Even in the U.S., many entrepreneurial businesses have limited access to capital markets. They have to "bootstrap" their ventures, using personal savings, borrowing from family and friends, drawing on personal credit cards, and taking home equity loans.[19] In developing countries, many entrepreneurs simply do not have access to this kind of "bootstrap" capital. Philanthropists may wish to fill this capital gap by selectively investing in profit-seeking businesses that have significant potential to increase economic participation of the poor. This could include, for instance, businesses owned by members of groups normally excluded from mainstream economic activity (such as, women, minorities, outcasts, etc.), businesses that locate in economically distressed areas and provide productive employment to people in those areas, or businesses that provide needed products and services to the poor, such as cell phones.[20] Philanthropists can also provide this support indirectly by supporting the development of a more open entrepreneurial economy in economically distressed areas, for instance, ventures that lower barriers to business formation, improve legal protections of property rights and enforcement of contracts, and increase access to capital, entrepreneurial education, and technical assistance.[21]

Some would take this point further, arguing that philanthropists should not limit their involvement to ventures that "need" philanthropic funding and cannot raise capital on private markets. Developing markets may benefit if there is a philanthropic voice among the investors backing major new private enterprises. Making a similar point, Nicholas Sullivan argues that Celtel, the highly successful African telecommunications company, benefited by taking funds from development finance organizations as well as mainstream venture capitalist.[22] Through strategically selected investments in private businesses that have major implications for the poor, philanthropists may enhance the social impact of those businesses. Their involvement may also give enterprises additional credibility as it negotiates with governments or interest groups.

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[19] See Amar V. Bhide's "Bootstrap Finance: The Art of Start Ups," *Harvard Business Review* (November 1992), and his book *The Origin and Evolution of New Businesses* (New York: Oxford University Press, 2000).
[20] Nicholas P. Sullivan, *Can You Hear Me Now: How Microloans and Cell Phones Are Connecting the World's Poor to the Global Economy*, (New York: John Wiley & Sons, 2007).
[21] This list draws on the discussion in William J. Baumol, Robert E. Litan, Carl J. Schramm, *Good Capitalism. Bad Capitalism, and the Economics of Growth and Prosperity*, (Yale University Press: New Haven, 2007), on pp. 153-163
[22] Nicholas P. Sullivan, *Can You Hear Me Now: How Microloans and Cell Phones Are Connecting the World's Poor to the Global Economy*, (New York: John Wiley & Sons, 2007): 116.

NEW CHALLENGES OF ENTERPRISING PHILANTHROPY

When business and philanthropy are treated as separate realms, practitioners have a relatively clear understanding of how to make decisions. This traditional logic of business investing focuses on wealth creation, considering factors such as risk, uncertainty, liquidity, and time horizon. The traditional logic of making grants focuses on achieving an intended social impact, considering factors such as a donor's philanthropic goals and alternative uses of the funds. Some observers object to this bifurcation, arguing for a common logic of "blended value" creation.[23] Whether or not a common logic can be developed, philanthropists who support enterprises are faced with creating a logic suitable to making decisions about supporting enterprises. This poses some new challenges. It is useful to discuss a few of the prominent ones.

Defining and measuring success. Measuring social impact is often difficult to do in a reliable, timely, and cost-effective fashion. Enterprise investments pose an additional challenge: To what extent should financial performance of the enterprise be included in the assessment of social impact, from a philanthropist's point of view? Even when profit is simply a means to an end, financial performance is an indicator of the ability of an enterprise to survive and grow in the future, with minimal (perhaps no) further philanthropic subsidy. This surely has value beyond the direct social impact achieved by the organization during the investment period. When a grant is made to a charity, it is often more of an expenditure than an investment, in the sense that the grant covers a portion of operating costs for the organization to do its work during a given period of time. In the next period, the organization needs a new grant. Donors are essentially paying for service delivery. In the case of enterprise, philanthropic support can help move the organization away from future dependence on any philanthropic subsidies. Philanthropic support for enterprise, even when it takes the form of a grant, is more of an "investment" in that (if successful) it yields benefits into the future. How should this ability to create future impact with less (or no) philanthropic support be factored into the "social return" of an enterprise investment? Failing to place a value on this will underestimate the social impact of an enterprise investment.

Setting the terms of engagement. Philanthropists who want to support enterprises also face a more complex array of options for structuring the deal. An enterprise may have the potential to repay the philanthropist for the financial support, now or later. Financial support can take the form of grants, recoverable grants, loans at various rates and on various terms, loan guarantees, and, in the case of for-profit enterprises, equity. In addition to the form and terms of initial financial support, the deal between a philanthropist and an enterprise can include conditions for follow-on funding, provisions for non-financial support (management assistance) or involvement (board membership), and exit strategies. These deals can be as simple as a basic charitable grant or as complex as a private equity transaction. In determining the terms of engagement, philanthropists investing in enterprises will have to grapple with how their support can create the most beneficial impact relative to the resource expended. Does the enterprise need a subsidy? If so, what is the best form (grant, low

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[23] Jed Emerson is the primary developer of the blended value concept, see www.blendedvalue.org for background material. Specifically see the World Economic Forum Report, *Blended Value Investing: Capital Opportunities for Social and Environmental Impact*, at http://www.blendedvalue.org/media/pdf-blendedvalue.pdf.

interest loan, etc.)? How long should one be willing to subsidize a social enterprise? Martin Fisher acknowledged that it is likely to take a long time before KickStart is able to achieve sustained profitability, but in the meantime, it is generating tremendous income gains for Kenyan and Tanzanian farmers, far in excess of the subsidy required.[24] Could some enterprises, because of their social impact, justify indefinite financial support? What conditions, positive or negative, should trigger an "exit" by the philanthropist? How will a positive exit be achieved? Most of these organizations are not likely to go public or even be acquired. How can the deal be structured to provide the right incentives and rewards to the management team for successful performance? How can it be structured to make the most cost effective use of the philanthropic capital?

It is important to note one significant implication of the possible range of deal structures with regard to determining a "social return on investment." The "investment" element must be calculated to reflect the net financial resources used to achieve the impact. Obviously, a $1 million grant has to be treated quite differently from a $1 million loan, even at 0% interest and even if the probability of repayment is only 50% ex ante. The grant is gone. With the loan, the philanthropist is likely to get back some capital, perhaps all the capital to use in the future. One way to think about this is to focus on the net costs of the investment (including transaction costs, monitoring costs, costs of in-kind assistance, etc.) relative to making a market rate investment of comparable risk.

Aligning incentives to assure the creation of intended social impact. When philanthropists invest in enterprises, they need to be confident that the incentives inherent in the enterprise are aligned with their intended social impact, or that safeguards are in place should financial rewards ever threaten to pull the organization away from the desired social impact. For most enterprises, managers will face decisions in which they have to make trade-offs between financial returns and social impact. Defining the optimal balance is not easy, since financial success may allow an organization to have greater social impact in the long term. How can a philanthropist develop confidence that a given enterprise is likely to produce the intended social impact? The best assurance is provided when market forces are perfectly aligned with the intended social impact. When the natural alignment is not obvious, it is wise for an investing philanthropist to look at other factors that could affect social performance. For instance, the legal form of an enterprise can vary widely, with different options falling into the broad categories of nonprofit, for-profit, cooperative,[25] or some combination. In the United Kingdom, social entrepreneurs can now choose a new legal form, the "community interest company," that allows limited financial returns to equity investors. Legal forms affect governance, forms of financing, and possible financial rewards to those in control of the organization. Perhaps more important than legal form is who controls the organization, by law and in practice, and what are their values and interests. In the case of for-profit social ventures, it is helpful for control to be kept in the hands of those who care about the social impact, but also understand the role of financial success as a means to that end.[26] Finally,

[24] Martin Fisher, "Income Is Development: KickStart's Pumps Help Kenyan Farmers Transition to a Cash Economy," *Innovations*, (vol. 1, no. 1, Winter 2006): esp. 26-30.
[25] In the category, I am including a variety of member-serving structures such as mutuals, credit unions, collaboratives, etc.
[26] For more on for-profit social ventures, see "For-Profit Social Ventures," with Beth Battle Anderson, in *Social Entrepreneurship*, edited by Marilyn Kourilsky, and William Walstad, (Senate Hall Academic Publishing, 2004) a special issue of the *International Journal of Entrepreneurship Education*, volume 2.

the culture, processes, and staffing strategies of an organization can work to align effort with the intended social impact.

Scaling the organization and the impact. How can philanthropists be sure that their enterprise investments will lead to significant, widespread impact? One potential drawback of an entrepreneurial approach to social problems is the existence of many small, fragmented efforts with little learning and sharing between them. The innovations embedded in the socially successful enterprises may not reach the vast majority of locations and individuals who could benefit from them. This might be fine if all solutions were truly local, but we have strong evidence that innovations in this sector can and should spread to new locations. Consider microfinance. If entrepreneurial business ventures are to put a serious dent in poverty, they need pathways to spread what works to new markets where it is also likely to work.

Geographic expansion typically requires new talent and capital. Both can be problematic. Social enterprises often require hybrid skills, blending business, political, and social savvy. We need to expand and develop talent pipelines; philanthropists who invest in social enterprise have a vested interest in supporting the development of those pipelines. Capital is a problem because investing in the original innovation seems to provide more visceral satisfaction than investing in the expansion, even though greater social returns may come from supporting the expansion. Many social entrepreneurs and philanthropists are attracted by the enterprise model because they believe it will reduce the need for outside capital to scale and that commercial success will significantly increase chances of raising capital for scale. For instance, One Roof, Inc, a for-profit social venture that provides essential services to the poor through a network of stores in Mexico and India, grew out of the nonprofit World Corps where leading staff members "determined that private capital, rather than philanthropic dollars, was the best means by which to 'scale up'."[27] This logic is clear, but we do not have evidence yet that mainstream capital will flow to these ventures or that they will be sufficiently profitable to finance their own expansion. Microfinance spread for over two decades largely with support from philanthropists, governments, and aid agencies. Private investment capital is only now starting to flow into the field. Beyond microfinance, there are not many recent success stories of enterprising social innovations that have scaled to affect millions of lives. Philanthropic support is likely to be needed for considerable time in the expansion of social enterprises. This support may fund experiments with new expansion strategies and structures, such as creative franchise systems, licensing of programs or technologies, and alliances with corporations, governments, or other social sector organizations. Philanthropists may also consider supporting the creation of new funding platforms that can help fuel expansion.

GETTING THE MOST OUT OF THESE EXPERIMENTS

We know from the success of microfinance that philanthropic support of enterprise activities can play a crucial role in combating poverty, but we do not know much about how to engage in this kind of investing effectively. We do not know its strengths and limits. Standards of practice do not exist. Performance benchmarks and evaluation criteria for social enterprise are often lacking. We need a better understanding of the conditions under

[27] See history page at www.OneRoof.com.

which business ventures can achieve significant, positive, lasting social impact. We need better understanding of how philanthropists and social investors can best contribute to that impact. And we need better understanding of the institutional structures and supports that would allow social enterprise to thrive. If we can deepen our understanding in these ways, we may find a new approach to social change, one that strategically blends philanthropy and business.

How can we gain this deeper understanding? We will gain it by learning from experience. Current activities create a cluster of experiments testing different ways to bring markets to bear on serious social problems. Some of these experiments will be successful; a significant number will fail or fall far short of expectations. The result should be the development of useful knowledge to increase the chances of success in the future. To assure that these experiments are not in vain, however, we need to approach them in a way that allows us to draw out the lessons, in a way that makes us better at supporting healthy, sustainable social development. The failures need to be "constructive failures."[28] This means capturing and sharing experiences, both the good and the bad. This means supporting rigorous research, not just financially, but with the active cooperation of philanthropists and social entrepreneurs. Philanthropists who venture into this arena are pioneers and will play a key role in shaping the institutions and standards that will guide us in the future.

[28] For a discussion of constructive failure in philanthropy, see Peter Frumkin, "Failure in Philanthropy: Toward a New Appreciation," *Philanthropy Roundtable* (July/August 1998): 7-10.